December 8, 2014

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Cooperative Capital Markets Regulatory System
c/o The Government of Canada
The Government of British Columbia
The Government of New Brunswick
The Government of Ontario
The Government of Prince Edward Island
The Government of Saskatchewan

Dear Sirs and Mesdames:

RE: Proposed *Provincial Capital Markets Act* and Federal *Capital Markets Stability Act*

I am writing on behalf of the members of The Investment Funds Institute of Canada ("IFIC"), in response to the recent release of the consultation drafts of the *Provincial Capital Markets Act* ("PCMA") and the federal *Capital Markets Stability Act* ("CMSA") – together, the "draft Acts"[1].

We appreciate the opportunity to provide comments on these draft legislative proposals and the governance and legislative framework set forth in the affiliated commentary document.

The creation of a Cooperative Capital Markets Regulatory System ("CCMRS" or "Cooperative System") is a watershed moment for Canada's capital markets, and must be handled with great care. We support the efforts of the participating jurisdictions to incorporate and strengthen Canada's existing securities regulatory framework into a harmonized cooperative model. We believe such a model will improve the efficiency and resilience of Canada's capital markets and help them better serve the needs of all Canadians by fostering long-term investment, effective risk management and economic growth.

Given both the centrality of the CCMRS to the future of our industry, and the fact that a number of significant details regarding its governance and legislative framework have not yet been defined or released for consideration, our comments in this letter focus on aspects of the draft Acts, in particular the CMSA, where the need for significant improvement is already evident. In this letter we discuss three main areas where there are deficiencies that should be addressed:

(1) the proposed approach to systemic risk which departs considerably from the best practices identified by other jurisdictions and international fora;

(2) the inability of stakeholders to consider the proposed detailed regulations concurrently with the proposed framework legislation, along with the absence of a comprehensive implementation plan that details how the new Capital Markets Regulatory Authority ("CMRA") will function within the CCMRS and what form of interface there will be between the CMRA and its counterpart non-participating jurisdictions; and

[1] IFIC is the voice of Canada's investment funds industry, bringing together 150 organizations, including fund managers and distributors and industry service organizations, to foster a strong, stable investment sector where investors can realize their financial goals. By connecting Canada's savers to Canada's economy, our industry contributes significantly to Canadian economic growth and job creation.

(3) the unilateral amendments to well-established rules without a full public consultation process such as that currently employed by the Canadian Securities Administrators.

Systemic Risk

Of greatest concern are the flaws in the CMSA's approach to systemic risk: (i) substantive and procedural deficiencies, including a lack of information about the consequences of designation, and lack of clear guidance, standards and due process protections, (ii) a focus solely on potential risks that is unbalanced by a mandate to identify, protect and enhance benefits flowing from the capital markets or a requirement to evaluate the costs and unintended consequences of additional regulation, and (iii) an unfounded presumption that investment funds and their managers contribute to systemic risk and therefore designation is justified, notwithstanding significant evidence to the contrary and the ready availability of a products- and activities-based approach, which offers a more effective and efficient structure for their regulation. We describe these flaws briefly below and look forward to discussing them with you in detail as we pursue our shared objective of improving Canada's capital markets.

We reviewed a copy of the comment letter being submitted by the Investment Company Institute ("ICI"), and fully endorse its analysis and comments in relation to the CMSA's proposed framework for assessment of systemic risk in relation to investment funds and investment fund managers. We note ICI's statements about the systemic risk assessment framework in the U.S. and elsewhere around the globe, particularly the caution that some of the proposals in the CMSA go beyond what is proposed by any other jurisdiction. As such, we urge the federal government to move cautiously and to ensure thorough and broad consultation before imposing a framework permitting unwarranted and disruptive designation of mutual funds and their managers as systemically important intermediaries.

As providers of long-term savings and investment options for millions of Canadians, we recognize the importance of mitigating systemic risks within Canada's capital markets. It is precisely because systemic risk regulation is so consequential – both for Canada's capital markets and the wider economy – that it must be approached thoughtfully, transparently and with the utmost care. For the CMRA to effectively regulate systemic risk, its enabling legislation must, at a minimum, clearly define "systemic risk", present a transparent and objective framework for how the CMRA will identify such risks within the market, clearly set out the model that will guide regulatory decision-making when risks are identified, provide due process mechanisms for designated market participants, and include clear provisions for assessing the costs, benefits and unintended consequences of regulatory action.

As proposed, the CMSA fulfils none of these vital tasks: it does not clearly define "systemic risk", nor does it suggest the framework regulators will use in order to assess systemic risk within the marketplace, or even detail the due process protections available to affected firms. Instead, the CMSA leaves these matters almost entirely in the realm of regulatory discretion.

<u>We believe that if it is adopted as proposed, the ill-defined and discretionary regulatory approach to systemic risk contemplated within the CMSA could cause severe harm to investment funds and their managers, with attendant disruptive consequences for Canada's retail investors, capital markets and economy.</u>

We have detailed our concerns in greater detail below. We respectfully request that the CMSA be revised to correct these flaws before it is adopted.

Systemic Risk Is Not Defined

From the outset, the CMSA provides insufficient clarity to the CMRA and market participants. The definition of "systemic risk related to capital markets" (Section 3(1)), which is the foundation of the CMSA, is overly broad and reliant upon undefined terms that raise more questions than they answer. For

example, what is a “threat to the stability or integrity of Canada’s capital markets”? How is “stability” defined and measured? Is market volatility a “threat” to stability? At what levels, in what sectors and for what duration? What harms could flow from such volatility that the CMSA seeks to prevent? The Act creates no clear standards for the CMRA or metrics for it to use to determine whether such standards are met.

According to the definition, a systemic risk must have the “potential to have an adverse effect on the Canadian economy” but how is “potential” measured and how large and sustained an adverse effect would warrant additional regulation? Similarly, the definition of “integrity” of the financial system includes terms that are undefined, qualitative and therefore immeasurable, such as “soundness,” “cohesion,” and “public confidence.” The definition of “systemic risk” is fundamental to the CMSA and its ambiguity creates problems throughout the Act. If adopted as proposed, the CMRA could not clearly define and pursue its mandate, and policymakers and the public could not measure its effectiveness.

No Objective Framework for Designations

Those definitional flaws are compounded by the absence of an objective framework for the CMRA to determine when to exercise the different authorities it is granted to identify and regulate systemic risk. For example, Section 32(1) empowers the CMRA to “prescribe a practice to be systemically risky if, in the [CMRA’s] opinion, the practice could pose a systemic risk.” In light of the vague definition of systemic risk and the absence of any objective process, economic models or metrics, that means that a practice is systemically risky if the CMRA opines that it is.

The CMSA provides no meaningful guidance regarding the process the CMRA should use to identify and regulate such practices. Although it lists a few factors that the CMRA must consider, it does not define or prioritize those factors, specify whether they are indicative of more or less risk, or describe how they will be measured. Rather, it undermines their importance and removes any limits they may have imposed on the CMRA’s discretion by authorizing the CMRA to consider and apparently attribute equal or greater weight to “any other risk-related factors that [it] considers appropriate.” (Section 32(2))

Due Process

There are broad grants of regulatory discretion and absence of required objective protocols throughout the CMSA. Considering the vague definition of “systemic risk”, together with the CMRA’s discretion to designate a company or practice as “systemically important”, together with its authority to impose a range of obligations on designated entities – including restricting or even terminating an intermediary’s activities or ordering “anything else that is necessary to address the risk”, the overall result is that the CMRA is given unconstrained discretion to affect the capital markets and individual participants. This is further compounded by the lack of a requirement to thoroughly assess the actual ramifications – to the entity, Canadian capital markets or the Canadian economy – of designating an entity as systemically risky. Without this key information, the CMRA cannot properly assess whether designation would be an appropriate, or an overreaching, injurious response. We would note, by comparison, that the designation process used by the Financial Stability Oversight Council in the U.S., while far from ideal, does contain much more in the way of due process safeguards than what is proposed in the CMSA. Given the importance of these markets and the costs and unintended results that would flow from designation, we believe that the CMSA should incorporate much stronger and more explicit due process protections for affected persons.

For instance, the CMSA (Section 27(3)) states that, when making an order designating a capital markets intermediary as “systemically important”, the CMRA must give the intermediary “an opportunity to make representations”. However, it is unclear what it means “to make representations” and what due process protections it will provide the intermediary. The CMSA specifies no timeframes, adjudicative standards or processes for submitting or responding to information or actions for the CMRA or the intermediary. The

CMSA should be revised to require that safeguards be built into the processes envisioned throughout the CMSA, such that affected persons can access the necessary information and procedural protections to challenge and inform regulatory actions that could materially affect their business and the capital markets.

Risks of Excessive Reliance on Regulatory Discretion

The proposed CMSA relies too heavily on regulatory discretion and, as a result, will not deliver one of the fundamental benefits that it should: the reduction of risk in the market without regulatory intervention. Sufficient clarity regarding what the CMRA should consider a systemic risk and the regulatory consequences would allow market participants to evaluate the costs and benefits of their business models, products and activities. Clear definitions and consequences applied within an objective framework would serve as a bright line as to activities that might lead to designation, and prompt many to better monitor and manage their risk profiles, thereby reducing risk in the system far more effectively than individual designations or other regulatory actions could. The CMSA, however, provides too little information to market participants and to regulators for that to occur.

Additional Information Needed and the Consequences of Failing to Provide It

Thus, we do not believe that the CMSA describes with sufficient precision the system it hopes to protect, the potential harm it seeks to prevent, or the methods the CMRA should use to analyze either or achieve its objectives. Unless these substantive and procedural deficiencies are corrected, they may produce ineffective and inefficient regulation that does more harm than good to the capital markets. The costs and unintended consequences of such regulation could significantly harm individual companies, their customers, financial markets and the Canadian economy. Shareholders have invested $1.13 trillion in over 2,150 Canadian mutual funds alone. These funds comprise 26% of Canadians' financial wealth and provide a means for over 4.6 million households to save for long-term goals such as buying a home and funding retirement. In doing so, they provide long-term financing to businesses and governments and help drive economic growth. The stakes are too high to proceed without the necessary clarity and framework. Consequently, we request that the CMSA be revised to define more clearly key concepts like "systemic risk" and create an objective framework for identifying it, determining whether regulatory action is required and selecting the best action.

Exclusive Focus on Risk without Consideration of Benefits, Costs or Unintended Consequences

As proposed, the purposes of the CMSA are to promote the stability and integrity of the financial system by managing "systemic risk related to capital markets" and to protect those markets against crimes (Section 4). These are worthy objectives, but they should be balanced by a mandate to identify, protect and enhance the economic and financial stability benefits created by the capital markets and their participants. Policymakers globally are endorsing such a balanced approach and we encourage you to do the same. For example, the President-elect of the European Commission recently specified that the mission of the new European Commissioner for Financial Stability, Financial Services and Capital Markets Union includes creating "a well-regulated and integrated Capital Markets Union . . . *with a view to maximising the benefits of capital markets and non-bank financial institutions for the real economy*."[2] The International Monetary Fund also recently remarked that, in regulating capital markets and non-bank intermediaries the key "challenge for policymakers" is to "maximize the benefits . . . while minimizing the systemic risks."[3]

[2] See p. 5, Mission Letter from Jean-Claude Juncker to Jonathan Hill, dated 10 September 2014, available at http://ec.europa.eu/about/juncker-commission/docs/hill_en.pdf. (*emphasis added*)

[3] See p.65, International Monetary Fund - Global Financial Stability Report: A Report by the Monetary and Capital Markets Department on Market Developments and Issues. 8 October 2014, available at https://www.imf.org/external/pubs/ft/gfsr/ (hereafter, the "IMF GFSR")

It would also be sound policy to require the CMRA to analyze the anticipated costs and benefits of its designations and other actions that could materially affect individual persons or the capital markets before the action is taken and at regular intervals thereafter. These analyses should be reported by the Chief Regulator to the Council of Ministers and the public annually.

Designating Funds and Their Managers Would Be a Flawed Approach to Regulating Any Risk They May Present; a Products- and Activities-based Approach Would Be Superior.

The costs and unintended consequences of regulation are likely to outweigh significantly any benefits when that regulation is structurally flawed, as designation of investment funds and their managers under the proposed CMSA would be. Designating individual funds and their managers for different regulation than their peers would be unjustified, ineffective and harmful to those entities, related investors and issuers, and to Canada's capital markets. The CMSA should therefore be revised to eliminate the authority to designate individual investment funds and their managers as capital markets intermediaries.

If risks arise from asset management that require the CMRA to act, they are extremely unlikely to be unique or limited to a single fund or manager or to a small group of either. In fact, they are certain to extend beyond a subset of funds and managers and highly likely to extend beyond the asset management sector. Asset management and the capital markets are characterized by high levels of competition and substitutability. Risk tends not to concentrate in individual entities or to do so for long. Therefore, any regulation that is narrowly focused will be structurally deficient. Accordingly, regulation of asset management should focus on those activities entities are engaging in that require risk mitigation; and the regulation should be targeted narrowly at a specific risk, such as excessive use of leverage or a lack of transparency, and applied broadly to all entities in the market that might present it, regardless of their type. The CMRA's designation authority should be used as a last resort, only in cases where the CMRA has concluded that a particular intermediary poses significant, demonstrable risks to the financial system that cannot otherwise be adequately addressed through other regulatory measures.

Designation of Investment Funds and Investment Fund Managers is Unjustified and Ineffective

Regulators are extremely unlikely to find an individual fund or manager that meets the criteria necessary to be designated as systemically risky. Funds are typically too small to individually threaten the Canadian financial system (section 27(2)(b)). They are also not vulnerable to "insolvency" or the kind of "financial distress" that designation is intended to address (section 27(2)(a)), which helps explain why, "unlike in banking, history is not littered with examples of failing funds wreaking havoc in financial markets."[4] In fact, many have recognized that funds are far more likely to reduce systemic risk than to increase it.[5]

That is due primarily to the fact that, unlike banks, investment funds are not financed primarily with debt. On the contrary, most funds employ little or no leverage and are essentially 100% equity capital. Equity capital absorbs any declines in the value of the fund's portfolio and functions as a "shock absorber" – mitigating potential systemic risk rather than creating or transmitting it.[6] In other words: even if the assets

[4] See "The age of asset management?" a speech given by Andrew G Haldane, Executive Director, Financial Stability at the Bank of England and member of the Financial Policy Committee at the London Business School, London, 4 April 2014, at p.6, available at http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech723.pdf

[5] See the IMF GFSR at 33 ("From a financial stability perspective, credit intermediation through asset managers and markets has advantages over that through banks". In noting specifically that investment risk is borne by the fund, not the manager, it continues, "there are no public guarantees like those the banking system has for deposits." Liquidity is provided mostly by markets, and not from bank holdings of liquid assets backed by central bank facilities. Finally, funds generally do not raise liabilities to fund assets and are therefore less leveraged than banks").

[6] See, e.g., ("[F]rom a purely systemic perspective, funds contain a specific "shock absorber" feature that differentiates them from banks" and mitigates potential "contagion effects in the broader financial system."), at p. 29 of the FSB/IOSCO - Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions, 8 January 2014, available at http://www.financialstabilityboard.org/publications/r_140108.pdf (hereafter, the "FSB/IOSCO Proposal")

within a fund decline in value, those losses are simply borne by the fund's investors, who tend to be investing to meet their long-term financial needs and less affected by short-term fluctuations in asset prices.

Mutual funds are routinely closed or merged, and fund managers exit the asset management business, for a variety of reasons. Even when these closures and exits occur during, or may be a result of severe market stress, they do not result in disorder that broadly affects the investing public, other market participants or financial markets generally. As the Financial Stability Board ("FSB") and the International Organization of Securities Commissions ("IOSCO") acknowledge[7], funds open and close regularly without market impact. That is due to many factors in addition to their equity capitalization. For example, they are also structurally and economically separate from their managers, and from other funds, and they are highly substitutable. That separateness prevents direct transmission of losses and their substitutability prevents risk from concentrating or remaining in a single fund (or its manager). Funds also operate within a comprehensive securities regulatory structure that is designed to mitigate risk to the system *and* protect investors. The improbability of failure and the minimal impact of funds exiting the market make designation unjustified.

Furthermore, investors alone own the managed assets in a fund; the investment/market risks inherent in a particular fund are borne solely by that fund's investors. The investors can and do easily and frequently move their investments from one fund to another, and from one manager to another, because the "investment fund industry is highly competitive with numerous substitutes existing for most fund strategies."[8] Designating a single fund or a small group within a broader class would be ineffective if the additional regulation simply prompted investors to shift their assets to undesignated funds.

Although a "run" on a fund could take place if the fund has significant leverage or fixed redeemable obligations and its investors fear that declines in the value of the fund's assets may reduce or eliminate the values of their equity investments, most funds do not have these characteristics. Rather, a typical mutual fund that operates with little or no leverage, has a floating NAV and marks its assets to market daily, fundamentally lacks the basic ingredients that are required for a "run."

Moreover, funds that do have some of those characteristics adopt safeguards to mitigate the risks they present. For example, leveraged hedge funds restrict redemption rights, and money market funds strictly limit the universe of investable assets and impose liquidity and other requirements, to ensure that they can handle shareholder redemptions.

For the vast majority of funds, however, concerns about "runs" and any consequent contagion or financial stability impacts are simply misplaced. The very attributes of mutual funds – their size, equity capitalization, long-term focus, strict regulatory requirements, including strict restrictions on use of leverage, and their agency model – mean that it is highly unlikely that a fund could threaten Canada's financial system. Even if a mutual fund should liquidate or merge, the process is orderly and without broader consequence to the markets. Ultimately, the structural and regulatory framework and substitutability of mutual funds within the industry makes designation an unnecessary regulatory response. Quite simply: mutual funds are beacons of stability within Canada's capital markets, and should be viewed as dampeners rather than originators of systemic risk.

The same is true of fund managers, only more so. As agents managing others' investments rather than investing for their own accounts, their balance sheets tend to be small and insulated from any direct

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[7] The FSB/IOSCO Proposal acknowledges that investment funds generally may decline in value through market losses and redemptions and may ultimately liquidate, but those liquidations "represent an ordinary phenomenon" and historically have not created a "systemic market impact." See the FSB/IOSCO Proposal at 31 n.39, 30 n.38

[8] Section 6.2.2 of the FSB/IOSCO Proposal, p. 30.

economic exposure to funds' investments.[9] Regulating an individual manager differently than its peers would not give the CMRA control of the assets in its funds or prevent other managers or other capital markets intermediaries from engaging in the activities that concern the CMRA.

Designation of Funds Would be Harmful

For a fund or fund manager, systemic risk designation would cause irreparable harm. Many investors would rush to exit a designated (or to-be designated) fund or company, compliance costs would rise dramatically, and the attendant regulatory uncertainty would place the affected firm at an untenable competitive disadvantage. In other words: many if not all managers would be unable to simply accept the uncertainty, costs and other burdens associated with designation. As noted above, the asset management market is highly competitive. Performance and fees are measured in basis points. A designated manager would bear costs not borne by its competitors and, as a result of the competitiveness and fee structures in the industry, it would be unable to pass these on to investors in its funds. Since a designated manager would face a distinct competitive disadvantage, we anticipate that over time its investors and professional talent would both migrate to undesignated managers.

Similarly, we expect many funds would liquidate if designated, or operate on a dramatically smaller scale after investors redeemed. The overall cost of designation would almost certainly reduce the competitiveness of the fund and, therefore, its appeal to investors. In such a competitive market, where multiple funds with quite similar investment strategies compete for investors, a designated fund's investors would simply leave and invest in a competing fund without the regulatory burden.

After all, at no time would a designated fund "own" its assets, and designating a fund would not give the CMRA or any other regulator control over those assets. Ultimately, the assets in a fund always belong to investors themselves. These assets would begin leaving the fund as soon as investors are notified of the designation proceeding.

Worryingly, the CMSA authorizes the CMRA to prohibit disclosure of such a proceeding (Section 38(10)). Although this provision could, in theory, aid the CMRA in mitigating systemic risk during a crisis period, it is built upon a fundamental flaw within the CMSA: that is, the failure to account for the statutory fiduciary duties that investment fund managers owe to the funds they manage. These duties are expressly contained in section 56 of the draft PCMA, which essentially preserves the language of section 116 of the *Ontario Securities Act*.

In addition to authorizing the CMRA to prohibit disclosure of material information to investors, the CMSA also grants the CMRA other authorities which may interfere with a manager's ability to meet its fiduciary duties to act in the best interest of a fund. These authorities include requiring it to sell a security (Section 29(1)(a)), prohibiting it from trading altogether, or requiring it to refrain from doing "anything else" (Section 34(2)(a)). The exercise of these authorities would fundamentally change the rules governing the relationships among managers, investment funds and their investors. They could, in turn, reduce investment overall or in certain sectors and not only prevent the CMSA from maintaining "public confidence" in the financial system (Section 3(2)(d)), but call into question the legal obligations of market participants themselves.

We are deeply concerned about the potential costs and unintended consequences that poorly designed regulation could impose on issuers, investors, the capital markets and the Canadian economy. Analysis of these potential outcomes should take place when legislation is drafted and should be a key element of a public consultation process so that policymakers and market participants can develop a full understanding

[9] See Sections 6.2.1 and 6.2.2 of the FSB/IOSCO Proposal, p. 30, including the footnotes in particular. These Sections explore the nature of the asset management business and include the rationale for the FSB/IOSCO decision to focus the proposed methodology on funds and not their managers.

of the ramifications of systemic risk designation. It should not be the sole burden of regulators who must implement it. Therefore we recommend that the authority to designate capital markets intermediaries be revised to exclude investment funds and their managers, just as it excludes other entities for which that additional regulation would be inappropriate (definition of “capital markets intermediary” and Section 27(1)).

Regulation of Products and Activities

To be clear, we are not recommending that investment funds and their managers be excluded entirely from analysis and potential regulation by the CMRA; rather we recommend that such analysis focus at the right level and any regulation take the optimal form. We recommend that the CMRA analyze the activities conducted by investment funds, their managers and other capital markets participants and the products they offer, rather than focus solely on individual entities or subsets. Any identified risks to the system should be addressed by targeted regulations that apply broadly to anyone involved in the activity or product that creates them. By restricting a particularly risky activity or product across the industry or relevant market, as regulators have done historically, the risk can be addressed effectively in total rather than partially and ineffectively in a few funds or managers.

This issue has been evaluated by policymakers around the world since the financial crisis and, for the reasons described above, many have recognized that a products- and activities-based approach has been successful in the past and is likely to be the optimal approach to regulating any systemic risk in the future because it reflects the essential characteristics of the industry. As no securities regulator has yet adopted a systemic risk focus on individual investment funds or their managers, and there is growing sentiment globally that activity-based regulation rather than entity-based systemic risk assessment is the correct approach, Canada should not act on the presumption that systemic risk regulation is needed with respect to mutual funds and fund managers. For example, the FSB and IOSCO recognized that an activities-based approach might be superior to the approach focused on individual funds that they initially proposed.[10] Most commenters on the FSB/IOSCO Proposal recommended such an approach[11] and their comments were sufficiently compelling that the FSB took the unusual step of approving a second consultation on the subject, which will be published around the end of 2014.[12]

In the U.S., the Financial Stability Oversight Council convened a conference of leading academics, members of industry and regulators to discuss the issue in May 2014 (“FSOC Conference”).[13] Many of the participants in that conference endorsed an activities-based approach[14]. Indeed, a wide range of academic experts cautioned that substantial analysis was needed in order to determine whether additional regulation is even needed. In fact, the FSOC Conference produced a steady stream of calls for careful examination before *any* regulatory action is taken. We agree.

There is a high risk of unbalanced costs and unintended consequences where regulation that will significantly impact investors, markets and the economy is promulgated based on insufficient analysis or incorrect assumptions. Therefore, it is imperative that rigorous analysis of hypothetical risks and both the intended and unintended consequences of additional regulation precede any regulatory action. Accordingly, we oppose the presumption that underlies Sections 27-29 of the draft CMSA and we look

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[10] See FSB/IOSCO Proposal at 32 (“[A]nother possible approach to assessing systemic risk in the asset management sector could be to consider possible financial stability risks that could arise out of certain asset management-related activities” and Q6-4 “Should the methodology be designed to focus on whether particular activities or groups of activities pose systemic risks?”)

[11] Comments are available at http://www.financialstabilityboard.org/publications/r_140423.htm

[12] See Press Release: FSB Plenary meets in Cairns, Australia, 18 September 2014, (“FSB, jointly with IOSCO, will publish a second consultative document around the end of 2014.”) available at http://www.financialstabilityboard.org/press/pr_140918.htm

[13] See http://www.treasury.gov/press-center/press-releases/Pages/jl2405.aspx

[14] For example, Professor Kim Schoenholtz of NYU stated that “as pragmatists, we probably agree that activities are a better way to regulate our capital markets.”

forward to reviewing a revised CMSA that addresses our comments. We note that, following the FSOC Conference, the FSOC publicly announced that it had asked staff to undertake a more focused review of industry-wide products and activities.[15] We strongly encourage you to take the same approach and not to presume that regulation is needed or that designation is appropriate given the potentially significant, but still unknown, consequences of designation to the individual intermediary and the industry.

Transition, Implementation and Harmonization

The current passport model and the framework of national instruments have served the investment funds industry rather well and we expressed our view that any new structure should ideally enhance, but certainly not diminish, the efficiencies in the current system. We recognize that a major undertaking, like the development of the CCMRS, will necessarily give rise to transition and implementation challenges and we want to work closely with the appropriate regulatory authorities to proactively identify any such challenges and mitigate their impacts on Canadian investment funds, investors and capital markets. The absence of the release of a comprehensive CCMRS implementation plan and detailed regulations prevents us from adequately assessing and providing input into the full impact of the CCMRS on our Member firms, the Canadian markets and continuing confidence in those markets; however, there are several specific areas that we believe warrant close attention during this legislative and regulatory process:

Interface with Non-Participating Jurisdictions

Since investment funds are typically originated in one jurisdiction and sold nationally, our members rely on the existence of a highly harmonized, efficient regulatory system across Canada. To maintain and perhaps improve upon the efficiencies the fund industry has enjoyed under the current regime, it will be critical that a collaborative relationship be maintained between the participating and non-participating members of the Cooperative System. Building a collaborative working relationship between participating and non-participating jurisdictions will largely determine the extent to which the CCMRS encounters transition and implementation challenges, but most importantly, maintain a strong level of confidence in the capital markets.

The forthcoming CCMRS regulations should clarify how the Cooperative System will interface with non-participating jurisdictions and begin to answer the many questions that we all have, including: How will the CMRA apply its legislation to any non-participating province? Will the non-participating provinces be required to implement all new CMRA regulatory proposals, in order to maintain uniformity across Canada? Or will the CMRA only develop new regulatory proposals in conjunction with the Canadian Securities Administrators ("CSA")? If so, what role will the CMRA play within the current CSA structure? Will the CMRA sit as a member of the CSA, and thus continue participating in the passport system? How will the CMRA incorporate the existing "National Instrument" regulatory framework into a new Cooperative System, and how might these instruments change during this incorporation period? And, what mechanism will be in place to ensure that existing exemptive relief orders remain in effect and/or are deemed to be modified as necessary to remain in effect as a result of the adoption of the CCMRS?

While we presume that many of these structural and transitional questions will be addressed in the CCMRS companion regulations, it is imperative market participants are given additional guidance in the months ahead about how the draft Acts and forthcoming regulations will interact with the existing rules, structures and procedures that govern Canada's capital markets.

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[15] In a public statement describing its meeting on July 31, 2014, the FSOC indicated that it "discussed its ongoing assessment of potential industry-wide and firm-specific risks to U.S. financial stability arising from the asset management industry and its activities. The [FSOC] directed staff to undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry." Available at http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/July%2031%202014.pdf

Investment Fund Manager (IFM) Rules

Under the uniform PCMA, the definition of and registration requirements for IFMs substantively adopts Ontario's existing regulatory framework, in that Ontario currently requires IFM registration in Ontario if any fund managed by the IFM has security holders in Ontario. This contrasts to the current British Columbia (BC) model, whereby IFM provincial registration is required only if the firm carries out some business activities within the province. Yet while both the BC and Ontario approaches were adopted following a formal public consultation process, the decision to incorporate the Ontario model into the harmonized provincial Act (in effect applying the Ontario model to all participating jurisdictions) was taken without public consultation. This raises procedural and policy concerns. We prefer the BC approach, as it is most closely aligned with the familiar "passport" model of registration and activity and is more appropriately grounded in the IFM needing to have a meaningful connection with the jurisdiction.

While we applaud efforts to harmonize securities regulation in Canada, we believe that when substantive differences exist between jurisdictions, the choice of one particular approach reflects a material regulatory change that should trigger the standard processes of stakeholder outreach and consultation. We have noticed a number of other examples where unilateral changes to existing rules have been made without the standard stakeholder outreach and consultation process. Furthermore, making changes to existing regulatory rules in place across the country, without concurrent changes to those rules in the non-participating jurisdictions should be avoided, as it creates further disharmony in the national rule-set leading to more concerns about a dysfunctional and possibly unstable regulatory environment. It would be preferable to launch the CMRA with the existing set of regulations and rules to maintain national consistency, and then engage in a proper public "rulemaking" consultation process involving all jurisdictions (as occurs now at the CSA level) to ensure changes continue to be implemented consistently whether or not the jurisdiction is a CMRA participating jurisdiction.

Conflicts

Another harmonization challenge is found within the conflicts section in PCMA. It would apply a duty to disclose and manage conflicts to both investment fund managers and investment funds. This is an extension of National Instrument 81-107, which is in force in all jurisdictions and provides a conflicts framework that only applies to fund managers. As with the IFM rule change detailed above, we note that this regulatory shift is being proposed without public discussion or stakeholder consultation.

Prospectus requirement

We further note an inconsistency between the current prospectus requirements and those contemplated in the PCMA. In existing provincial securities law (such as Part XV of the *Ontario Securities Act*) the trigger for requiring prospectus registration is "trading", while in the PCMA, the trigger is referred to as "distribution". Accordingly, we request clarification as to whether this inconsistency is a deliberate regulatory choice or a matter that will be further addressed in the companion regulations. We also note that "distribution" is not defined in the PCMA. If the intent is for a "distribution" to trigger the prospectus requirement, it is important that this term be defined and that the change be exposed to a general rulemaking consultation to identify and allow all stakeholders to assess and consider the consequences of such a change.

Recommended Sunset Provision

We highly recommend that, consistent with federal financial institutions legislation, a sunset provision be included in the CMSA and PCMA that will require a review of the legislation, and the regulations and rules made under the legislation, every five years. Such a statutory review process would on a regular basis bring together all stakeholders to propose and consider necessary or desirable updates and revisions to the regulatory regime to ensure it remains up-to-date with market developments, rationalized as to any

duplication and overlap, and harmonized as between CMRA participating and non-participating jurisdictions. This process has proven to be a very successful and efficient way to maintain the federal legislation and would avoid the tendency towards continually adding more rules without holistically assessing them in the context of existing related rules. By including it now at the formative stage, it will build in the necessary review discipline that ensures regular modernization of the rules.

Conclusion

Although we have identified specific flaws as well as challenges arising from the draft Acts, we reiterate our support for the overall objective. We also note that our comments are necessarily provisional and incomplete because we can only assess the details of the CCMRS that are available to us. We will have further comments on these Acts once the companion regulations are released. It would be helpful to have a 120-day comment period on the companion regulations, and an additional opportunity to comment on the draft Acts together with the companion regulations. Giving stakeholders the opportunity to provide informed comments on all aspects of this vitally important regulatory endeavor as a whole before it is finalized will elicit more complete and constructive input.

We thank you for considering our comments at this stage of the CCMRS building process, and we look forward to working with all provincial securities regulators and the new CMRA during the transition to what we hope will be a well-functioning Cooperative System. We believe that meaningful consultation and stakeholder outreach during this transition will help to mitigate any disruption within Canada's capital markets and increase the chances that we will achieve our common objective: an efficient, resilient financial system that serves the needs of all Canadians and facilitates sustainable economic growth. In that spirit we would welcome an opportunity to discuss our concerns with you in more detail at your convenience. Should you have any questions or wish to discuss these comments further, please contact me directly, or my colleagues Ralf Hensel, General Counsel, Corporate Secretary and Director of Policy at 416-309-2314 (rhensel@ific.ca) or Graham Smith, Senior Policy Advisor at 416-309-2328 (gsmith@ific.ca).

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

Joanne De Laurentiis
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